Supreme Court, U.S.
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No. 03-891

IN THE

Supreme Court of the United States

DAVID A. GILL, Chapter 7 Trustee,

Petitioner,

v.

STEVEN H. STERN, Individually, and as Trustee of the Steven H. Stern, Inc. Profit Sharing Plan,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

DAVID R. WEINSTEIN
Counsel of Record
SHARON Z. WEISS
WEINSTEIN, EISEN & WEISS LLP
1925 Century Park East
Suite 1150
Los Angeles, CA 90067
(310) 203-9393

Attorneys for Respondents

185292

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

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REASONS FOR DENYING THE PETITION

While it is true that this case presents a question about "the intersection of fraudulent transfer law and exemption planning", Petition for Certiorari at *i*, it is *not* true that a circuit split exists over the question presented here. Morever, even if there are differing results among the circuits, certiorari is not warranted because the underlying question relates exclusively to the operation of different states' exemption laws. No federal question of pervasive national importance exists that this Court could resolve on a common plane.

A. There is no "split" because both the Eighth and Ninth Circuits allow a bankruptcy court to take into account evidence of fraud that is extrinsic to the successful conversion of non-exempt assets into exempt assets. *Compare In re Sholdan*, 217 F.3d 1006, 1010-11 (8th Cir. 2000) ("there was ample evidence extrinsic to the mere conversion of assets") with *In re Stern*, 345 F.3d 1036, 1044 (9th Cir. 2003), where the Ninth Circuit quotes from its earlier decision in *Wudrick v. Clements*, 451 F.2d 988 (9th Cir. 1971), which recognized that "[a] different case would be presented if on the eve of bankruptcy [to create exempt assets] a debt were created with no intention of repaying the creditor, either by purchasing goods on credit or borrowing money without security." *Wudrick*, 451 F.2d at 990.

Petitioner's problem is not that the circuits conflict, but that the trustee in *Sholdan* was able to tender evidence of extrinsic fraud that was sufficient to nullify the exemption, while Petitioner could not meet his burden here, even to show a triable issue. This does not amount to a split in the circuits. Rule 10 of the Rules of the Supreme Court.

B. Moreover, the legal "intersection" Petitioner writes about is decidedly local in flavor. While Petitioner seeks to draw the Court's attention with liberal references to ERISA, in fact, the fraudulent transfer law Petitioner invoked was the California UFTA and the exemption scheme asserted by Respondent is part of the California Enforcement of Judgments Law. Indeed, in the *Statutes Invoked* section of his Petition, Petitioner refers only to the California Civil Code (the California UFTA) and the California Code of Civil Procedure (the California Enforcement of Judgments Law). No other circuit has addressed how these California statutes operate in concert with each other, so the circuits cannot be "split" over the question raised here. Neither are federal questions or issues of national importance raised by how two California statutes interact.

The most favorable characterization of the circumstances Petitioner could claim is that the Eighth Circuit has decided that "filling up" Minnesota exemption categories on the eve of a bankruptcy filing could be fraudulent, while the Ninth Circuit decided that "filling up" California exemption categories on the eve of a state law levy cannot be fraudulent. But since the underlying exemption schemes are different, and were established by different legislatures to reflect different — and local — legislative dynamics and values, there is no pervasive, national and uniform plane upon which this Court can address, much less resolve, the questions Petitioner raises.

STATEMENT OF CASE

A. *Material Background and Circumstances.*

While Petitioner provides a colorful — and one-sided — history in the *Fraudulent Transfer* section of his Petition (pp. 4-7), it is clear that most of this "background" is designed

primarily to curry visceral sentiment against Respondent because it is irrelevant to the legal issue Petitioner himself presents. That is, allegations that Stern fraudulently transferred certain assets to third persons are not relevant to analyzing whether Stern's decision to convert into exempt form *other* assets he owned — and continues to own — is "fraudulent" such that the state law exemption scheme should be unavailable to Stern.[1] Those allegations about fraudulent transfers allegedly made to third persons are equally irrelevant to the question whether the retention of assets by Stern after they were converted to exempt form is somehow a fraudulent *transfer*.

What *is* relevant is that beginning in 1974, Steven H. Stern began saving for his retirement and while he used a variety of investment vehicles for that purpose, he always maintained his interest in the same Retirement Assets, never transferring the Retirement Assets to anyone else. Indeed, other than market fluctuations, the corpus of the Retirement Assets has not materially changed since 1989.

As time passed, Congress and the California Legislature established or sanctioned different investment vehicles and Respondent "rolled" his Retirement Assets from one vehicle to another as the applicable laws and pertinent circumstances evolved. Prior to 1992, Stern rolled over the Retirement Assets into an Individual Retirement Account ("IRA") when the corporate sponsor of a prior corporate plan dissolved in 1989. In 1992, three years before he filed his bankruptcy case, Stern again rolled over his Retirement Assets, this time back into a corporate retirement plan (the "1992 Rollover").

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1. Indeed, allegations that Stern fraudulently transferred assets to a third-party were alleged in separate claims not at issue in the underlying summary judgment motion and have now been dismissed by the Petitioner.

Stern filed his bankruptcy petition in August 1995 and claimed his interest in the Retirement Assets exempt from the bankruptcy trustee's administration.[2]

B. ***Proceedings Below.***

Petitioner sued to recover the Retirement Assets on a fraudulent transfer theory.[3] He also separately objected to Stern's claim of exemption of the Retirement Assets. Petitioner claims the 1992 Rollover is a fraud because the 1992 Rollover occurred soon after a state court judgment was entered against Stern on an arbitration award, but since it was undisputed that in the corporate retirement vehicle the Retirement Assets met the standards and limitations on the state law exemption, the most this proved was the purposeful conversion of assets into exempt form. Moreover, there existed the equally undisputed fact that other, surrounding circumstances had further evolved, such that use of a corporate business structure and associated retirement vehicle had again become advisable. Thus, Petitioner produced no *extrinsic* evidence of fraud pertinent to the assets claimed to be exempt.

Despite the fact that there is no direct evidence on point in the record, and despite the presence of evidence tending to prove the 1992 Rollover was motivated by the coincidence of evolving business circumstances, Stern repeatedly agreed that

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2. Stern alternatively argued that the Retirement Assets were excluded from the bankruptcy estate. Petitioner prevailed on this issue before the Ninth Circuit and it is the subject of a Conditional Cross-Petition for Certiorari.

3. Notably, Petitioner sued the third party transferees over the first group of assets, but never proved they were fraudulent transfers either.

the courts below could assume the 1992 Rollover was motivated, at least in material part, by his desire to be sure he could shield from creditors' hands the most that the California exemption law would allow. Stern prevailed in proceedings before the bankruptcy court, the district court and the Ninth Circuit.

The courts below held that it is not "fraudulent" to do what the law contemplates. That is, it is not fraudulent for one who suffers a judgment to read, think about and take advantage of laws that exempt identified assets from the seizure rights of a levying judgment creditor. And although the courts did not deploy this reasoning, neither was there a transfer of the assets claimed to be exempt, since Stern owned the same Retirement Assets before the 1992 Rollover that he owned after the 1992 Rollover. Since there was no "transfer", and there was nothing "fraudulent" about the 1992 Rollover, the courts below were quite correct to dismiss the Trustee's fraudulent transfer lawsuit. No circuit split resulted and no federal question arose.

ARGUMENT

A. *Fraudulent Transfer Laws and Exemption Laws Address Entirely Different Circumstances.*

Fraudulent transfers are *conveyances* by a debtor (or debtor-to-be) by which she divests herself of ownership of a thing but typically retains *de facto* influence and control over it. Or, she has gotten nothing for it. Either way, it is the *hypothecation* out of a debtor's estate, so that the thing is not amenable to levy, that triggers fraudulent *transfer* scrutiny. Likewise, the defendant in a fraudulent transfer action is not the judgment debtor, but a third person who received assets from the judgment debtor and who might be ordered to return them — not to the judgment debtor, but to his creditors.

Exemptions are different. Exemption rights operate only with respect to assets *still owned by a debtor* on the Scrutiny Date (typically, the date of a bankruptcy petition or a judgment creditor's levy). That is, the asset in question is owned by a debtor and thus amenable to levy, but debtor protection laws insulate it from forced sale. Thus, in contrast to a fraudulent transfer lawsuit, in exemption litigation, the defendant (respondent) is the judgment debtor himself. It follows that what Petitioner caustically describes as "exemption planning", does not involve a *transfer by the debtor* at all. Rather, it involves planning as to how a person is best advised to hold the property he owned and continues to own.[4]

B. *There is No Circuit Split Over the Issues Decided Here.*

The legal intersection Petitioner writes about is not normally controversial because "filling up" exemption categories is recognized to be different from fraudulent transfers. Indeed, it simply makes no sense for a debtor's creditors to concern themselves with purportedly fraudulent transfers *to* their judgment debtor. The Eighth Circuit in *Sholdan* acknowledges that a debtor is allowed "to convert non-exempt assets into exempt property for the express purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors", 217 F.3d at 1011, *citing Kangas v. Robie*, 264 F.2d 92, 93-94 (8th Cir. 1920). *Accord*, *Forsberg v. Security State Bank*, 15 F.2d 499,

4. In some "exemption planning" situations, non-exempt property is traded for exempt property, or is liquidated so the proceeds can be used to buy exempt property. Either way, even though there are nominal transfers, the total value of the debtor's estate remains essentially the same. This case presents an even narrower version of "exemption planning", one where the *same assets* are owned before and after the Scrutiny Date, and only the ownership vehicle or framework is slightly different.

501 (8th Cir. 1926). Similarly, the Ninth Circuit has stated, twice, " 'that the purposeful conversion of nonexempt assets to exempt assets on the eve of bankruptcy is not fraudulent per se.' " *Stern*, 345 F.3d at 1043, quoting *Wudrick*, 451 F.2d at 989.

The concepts are in tension only where the assets claimed as exempt are affected by facts assertedly establishing a fraud that goes materially beyond the creation of exempt assets (or the conversion of non-exempt assets into exempt assets).[5] Although varying fact patterns may cause tension between these concepts, this tension does not mean the circuits are "split" for purposes of certiorari to this Court.

In *Sholdan*, a 90 year old Minnesotan cashed out some savings deposits, sold payment rights and bought a $135,000 house he claimed exempt as a homestead. The trustee attacked the exemption and the *Sholdan* court held that there existed sufficient facts, extrinsic to the alleged creation of an exempt asset, to establish actionable intent to defraud such that Mr. Sholdan lost his right to *Minnesota* exemptions. From this, Petitioner concludes that Mr. Stern should have lost his right to *California* exemptions.

That Petitioner did not achieve his desired goal is not due to a split in the circuits' legal reasoning but rather to the fact that Petitioner's evidence was simply not as strong as the trustee's evidence in *Sholdan*. Indeed, in *this* case, Petitioner had *no* such evidence. In this case, the bankruptcy court repeatedly asked Petitioner's counsel to explain what facts he would show at trial, *apart from the purposeful and successful conversion*

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5. But even here, the fraudulent *transfer* theory petitioner advanced could not be viable because Stern never *transferred* anything.

of non-exempt assets into exempt assets. Petitioner could never answer the court's question, other than to point to surrounding circumstances, *i.e.*, transactions he claimed showed there were fraudulent transfers *to third parties*. But evidence of what Stern did with Asset Group A is not relevant to whether Asset Group B is exempt.[6] The extrinsic evidence Petitioner needed to adduce, but could not, had to pertain to the assets he claimed as exempt, not some other assets. Petitioner never offered evidence of extrinsic fraud relating to the assets Stern claimed as exempt.

In contrast, the trustee in *Sholdan* had more to show, namely that Mr. Sholdan did not intend to reside in the "homestead". This extrinsic fact directly affected the asset claimed to be exempt and went far beyond the mere purposeful conversion of non-exempt assets into *exempt* assets. Indeed, this extrinsic fact *negated* the creation of exempt assets and the whole point in *Sholdan* was that *no exempt asset was actually created*, while Mr. Sholdan presented a charade that it was. In the words of the Eighth Circuit,

> [i]t is one thing to convert non-exempt assets into exempt assets for the express purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors. However, it is quite another thing to acquire title to a house for no other reason than to defraud creditors.

217 F.3d at 1011. That is, acquiring title to a house is not the same thing as establishing a homestead and only a homestead is exempt. *This* fraud, quite different from successful creation of an exempt asset, defeated Mr. Sholdan's claimed exemption.

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6. Moreover, Petitioner did not ever prove the third-party allegations. Please see footnotes 1 and 3.

Thus, *Sholdan* does not endorse a trustee's use of fraudulent transfer law to take exempt property from a debtor, or to negate an exemption otherwise established under non-bankruptcy law. Indeed, in *Sholdan*, while the Eighth Circuit discussed Mr. Sholdan's intent to defraud, it never identified anything that Mr. Sholdan transferred, so it cannot be said that the *Sholdan* court relied on fraudulent transfers to void an exemption. Yet that is exactly what Petitioner tried to do here, so *Sholdan* is not "split" from the case Petitioner presented.

In short, *Sholdan* is a case where the debtor failed to establish the facts needed to create a *Minnesota* exemption. *Stern* is a case where the debtor *succeeded* in establishing the facts needed to create a *California* exemption. This difference in outcomes, on these questions, hardly establishes a "split" in the circuits.

Petitioner's other citation, *Tavenner v. Smoot*, 257 F.3d 401 (4th Cir. 2001), is even more readily distinguished from *Stern*. In *Tavenner*, the debtor made actual transfers of money to pay "wages" to, and buy a home for, his son; to buy cars for other relatives; and other such mischief. 257 F.3d at 405. This was a true fraudulent transfer environment, so it is different from both *Sholdan* and this case, and the issue was whether the transfers were voidable where the asset would have been exempt, had the transfers not yet been made when the Scrutiny Date arrived. 257 F.3d at 405-06.

Tavenner is thus different from both *Stern* and *Sholdan* in that the debtor hypotheticated assets and *then* claimed them exempt (although it is like *Sholdan* in that the exemption failed for lack of a threshold showing). That is, in *Tavenner*, the transfer defeated the exemption; whether it was *fraudulent* or not really was irrelevant. It follows that *Tavenner* and *Stern* do not create

a split in the circuits because they address different facts and different legal issues.

C. *No Compelling Federal Interest is At Stake in Exemption Planning Cases.*

Since it is clear that the three circuit-level decisions cited by Petitioner in fact create no cognizable "split", certiorari is not warranted unless a compelling federal interest has been put in play. Rule 10(c) of the Rules of Supreme Court. No such circumstance exists here.

How the several states, and bankruptcy courts sitting in them, interpret and apply their own state exemption laws is a peculiarly local issue. *In re Arro*, 170 F.3d 934, 935-36 (9th Cir. 1999) (debtor entitled to assert state law exemptions if the state where the bankruptcy petition has been properly filed has not "opted out" of the federal exemption scheme); *In re Ginther*, 282 B.R. 16, 20 (Bankr. D. Kan. 2002) ("exemption laws are local and 'pertain to the remedy having no extraterritorial effect.' ") Exemption laws vary greatly, properly so.[7] It would be nearly meaningless for this Court to attempt to decide what is and is not permissible "exemption planning" on a blanket basis when there are no blanket exemption laws for the pronouncement to apply to.

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7. The Bankruptcy Code recognizes that each state decides what exemptions are allowable in its own courts, and also authorizes the states to decide what exemptions can be claimed by bankruptcy debtors resident in the state. This is one of the only areas where rights to property in bankruptcy cases is left to state-to-state decisions. *See Patterson v. Shumate*, 504 U.S. 753, 758, 112 S. Ct. 2242, 2246, 119 L. Ed. 2d 519 (1992) (when it desired to do so, Congress has restricted the scope of applicable law to "state law").

CONCLUSION

It cannot be "fraudulent" for someone who has suffered a money judgment under state law to do what state law debtor protection statutes specifically contemplate. *No* circuit has held that where all that occurs is that exempt assets are successfully created from assets that not have been exempt, exemption rights are lost. There certainly can be no "split" where the circuits do not disagree on the underlying principle.

Likewise, the circuits are in agreement that *extrinsic* evidence of fraud, that goes *beyond* the mere creation of exempt property, could negate a debtor's right to an exemption. The difference between this case and the citations with which Petitioner tries to contrast it is that he had no evidence on the issue. This is not cause for certiorari to this Court. There being no federal rights, obligations or remedies put in issue by Petitioner,[8] certiorari should be denied.

Respectfully submitted,

DAVID R. WEINSTEIN
Counsel of Record
SHARON Z. WEISS
WEINSTEIN, EISEN & WEISS LLP
1925 Century Park East
Suite 1150
Los Angeles, CA 90067
(310) 203-9393

Attorneys for Respondents

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8. Not incidentally, a federal issue *does* exist in this case, but it arises only in connection with Respondent's Cross-Petition. Petitioner prevailed below on his argument that the Retirement Assets in question were not *excluded* from the bankruptcy estate under ERISA and *Patterson v. Shumate*. Hence Respondent can and does raise a federal issue but Petitioner does not.